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COPIES OF LETTER FILED

LL Docket #96-98

April 20, 1998

Memorandum of Ex Parte Communication

Magalie Salas
Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Dear Ms. Salas:

Re: *CCB/CPD 97-30 – Request by ALTS for Clarification of the Commission's Rules
Regarding Reciprocal Compensation for Information Service Provider Traffic*

Today the attached letter associated with the above-listed proceeding was delivered to Mr. Ed Krachmer of the Common Carrier Bureau. We are submitting the original and one copy of this Memorandum to the Secretary in accordance with Section 1.1206(b)(2) of the Commission's rules.

Please stamp and return the provided copy to confirm your receipt. Please contact me at (202) 326-8889 should you have any questions.

Sincerely,

A handwritten signature in cursive script, appearing to read "Jay Bennett", written over a horizontal line.

Attachment

A small, handwritten mark or signature in the bottom right corner of the page.

Jay Bennett
Director-
Federal Regulatory

SBC Communications Inc.
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Washington, D.C. 20005
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April 20, 1998

Mr. Ed Krachmer
Competitive Pricing Division
Federal Communications Commission
1919 M Street, N.W., Room 518
Washington, D.C. 20554

Dear Mr. Krachmer:

Re: *CCB/CPD 97-30 – Request by ALTS for Clarification of the Commission's Rules
Regarding Reciprocal Compensation for Information Service Provider Traffic*

Attached is a copy of Pacific Bell's "Opposition to the Motion of the California Telecommunications Coalition for an Order Regarding Calls to Internet Service Providers." The document demonstrates that Internet calls are interstate in nature and includes materials describing ISP configurations that extend beyond the local calling area.

Please contact me at (202) 326-8889 should you have any questions.

Sincerely,

A handwritten signature in cursive script, appearing to read "Jay Bennett", written in dark ink.

Attachment

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

| | | |
|---|---|-------------|
| Order Instituting Rulemaking on the |) | R.95-04-043 |
| Commission's Own Motion Into |) | |
| Competition for Local Exchange Service. |) | |
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| Order Instituting Investigation on the |) | I.95-04-044 |
| Commission's Own Motion Into |) | |
| Competition for Local Exchange Service. |) | |
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PACIFIC BELL'S (U 1001 C) OPPOSITION TO THE MOTION OF THE CALIFORNIA
TELECOMMUNICATIONS COALITION FOR AN ORDER REGARDING CALLS TO
INTERNET SERVICE PROVIDERS

Pacific Bell opposes the motion of the California Telecommunications Coalition ("Coalition") for an order declaring that calls to Internet service providers ("ISPs") are local calls. ISP communications are interstate in nature and under the express and declared jurisdiction of the Federal Communications Commission. Furthermore the CPUC has this same issue under consideration in other proceedings.

I. INTRODUCTION.

The Coalition's Motion should be denied because (1) ISP traffic is interstate by definition, (2) the method by which traffic is routed through ISPs demonstrates that the traffic is not local, and (3) reciprocal compensation for ISP traffic - that is almost all one-way - is anti-competitive, uneconomic, and places an extraordinary

Motion of The California Telecommunications Coalition For An Order Regarding Local Calls to Internet Service Providers, dated March 18, 1998 (the "Motion").

and unfair financial burden on the carrier (whether CLC or Pacific Bell) that is not serving the ISP. If the Commission does not deny the Motion, these issues should be addressed in a broad rulemaking that focuses on whether ISP traffic is interstate and the merits of bill-and-keep arrangements versus reciprocal compensation for the exchange of ISP traffic.

II. DISCUSSION.

A. The FCC And The Courts Have Characterized ISP Traffic As Interstate. That Characterization Is Supported By The Routing Of The Traffic.

As far back as the early 1980s, the FCC addressed the regulatory treatment of "enhanced services" as interstate services. Enhanced services included "information services" involving "interaction with stored information" through a combination of "basic telecommunication service and computer processing."² The FCC voided "inconsistent state regulation of [interstate] facilities or services" involving enhanced services.³ "Enhanced services" were later defined to specifically include computer database services such as Dow Jones News and Lexis.⁴ The FCC later defined "enhanced services" to include Internet traffic.

In 1983, the FCC determined that "enhanced service providers" would be exempt from access charges, even though there was no question that such users accessed the local network in a manner identical to other interstate users. The FCC founded this admittedly discriminatory and unprecedented action on the basis that the communications from these providers were interstate in nature, thereby

² See *Computer & Communications Indus. Ass'n v. FCC*, 693 F.2d 198, 205 & n. 18 (D.C. Cir. 1982).

³ *Id.*

⁴ *People of the State of Cal. v. FCC*, 905 F.2d 1217, 1223 & n. 3 (9th Cir. 1990).

conferring jurisdiction on the FCC. Its reasoning was based on the long standing rule that the jurisdictional nature of a communication, including communications provided by enhanced service providers, flowed from the communication's origination and termination points:

Among the variety of users of access service are facilities-based carriers, resellers (who use facilities provided by others), sharers, privately owned systems, *enhanced service providers* and other private line and WATS customers, large and small, who "leak" traffic into the exchange. In each case the user obtains local exchange services or facilities which are used, in part or in whole, for the purpose of completing interstate calls which transit its location and, commonly, another location in the exchange area. At its own location the user connects the local exchange call to another service or facility over which the call is carried out of state. These may consist either of owned or leased transmission capacity or a specific message service such as WATS. Depending upon the nature of its operation, a given private line or WATS user may or may not make significant use of local exchange service for interstate access. Thus, in the case in which a user connects an interstate private line to a PBX, some traffic may originate and terminate at the user location and other traffic may "leak" into the exchange in order that the calls can be completed at another location. A facilities-based carrier, reseller or *enhanced service provider* might terminate few calls at its own location and thus would make relatively heavy interstate use of local exchange services and facilities to access its customers. Hereafter we shall use the term "leaky PBX" to denote the generic problem just described, *whether the "leak" occurs through a PBX or through another mechanism or instrumentality.*⁵ (Emphasis added.)

In 1988 the FCC continued its jurisdiction over enhanced service providers and extended their exemption from access charges, justifying this discriminatory

⁵ *Re MTS and WATS Market Structure, Memorandum Opinion and Order*, CC Docket No. 78-72, FCC No. 83-356, 97 FCC 2d 682, 711-12, released Aug. 22, 1983.

action largely on the ground that information providers represented an infant industry in need of sheltering from access charges.⁶ Even more recently in its order on access charges, the FCC maintained this highly preferential treatment of ISPs, noting its special application to Internet access providers.

In the 1983 Access Charge Reconsideration Order, the Commission decided that, although information service providers (ISPs) may use incumbent LEC facilities to originate and terminate interstate calls, ISPs should not be required to pay interstate access charges. In recent years, usage of interstate information services, *and in particular the Internet and other interactive computer networks*, has increased significantly. Although the United States has the greatest amount of Internet uses and Internet traffic, more than 175 countries are now connected to the Internet. As usage continues to grow, information services may have an increasingly significant effect on the public switched network. (Emphasis added.)

As a result of the decisions the Commission made in the Access Charge Reconsideration Order, ISPs may purchase services from incumbent LECs under the same intrastate tariffs available to end users. ISPs may pay business line rates, and the appropriate subscriber line charge, rather than interstate access rates, even for calls that appear to traverse state boundaries.

These holdings were themselves consistent with the United States Supreme Court's characterization of Internet traffic as interstate, if not world-wide, in nature.

The Internet is an international network of interconnected computers...eventually linking with each other, now enable tens of millions of people to communicate with one another and to access vast amounts of information from around the world. The Internet is a 'unique and

⁶ *Re Amendments of Part 69 of the Commission's Rules Relating to Enhanced Service Providers*, Docket No. 87-215, 3 FCC Rcd. 2631, released April 27, 1988.

⁷ *Re Access Charge Reform*, First Report and Order, CC Docket No. 96-262, FCC No. 97-158, mimeo. pp. 153-54, released May 16, 1997.

wholly new medium of worldwide human communication.' (citation omitted).

Individuals can obtain access to the Internet from many different sources, generally hosts themselves or entities with a host affiliation...an increasing number of storefront "computer coffee shops" provide access for a small hourly fee. Several major national "online services" such as Microsoft Network, and Prodigy offer access to their own extensive proprietary networks as well as a link to much larger resources of the Internet.

Anyone with access to the Internet may take advantage of a wide variety of communications and information retrieval methods...All of these methods can be used to transmit text; most can transmit sound, pictures, and moving video images. Taken together, these tools constitute a unique medium --- known to its users as "cyberspace" located in no particular geographical location but available to anyone, anywhere in the world, with access to the Internet.⁵

The key legal definition of Internet (and other information services) communications is that they are interstate, if not world-wide, in nature. Nothing in the treatment of this traffic suggests that it is "local" in nature. A long line of cases in the federal courts, and elsewhere, has relied on a communication's point of origination and termination to determine whether the call is local or essentially toll in nature.⁶ Unmistakably, the vast majority of Internet communications originating, for example, in the Bay Area will terminate outside the San Francisco LATA, in other states, or in foreign countries.

⁵ *Reno v. American Civil Liberties Union*, __ U.S. __, 117 S.Ct. 2329, 138 L.Ed.2d 874 (1997).

⁶ See, e.g., *New York Telephone Company v. FCC*, 631 F.2d 1059, 1066 (2d Cir. 1980); see also, *United States v. AT&T*, 57 F. Supp. 451, 454 (S.D.N.Y. 1944), aff'd sub nom *Hotel Astor v. United States*, 325 U.S. 837 (1945).

The Commission itself has also recognized the interstate character of ISP traffic. In comments filed with the FCC, the Commission specifically referred to internet usage as interstate.

Given the complexity of today's telecommunications network and the rapid development in telecommunications technology, ***the proportion of interstate usage is increasing (e.g., internet usage)*** such that the states should not be required to bear sole costs for interconnecting facilities.¹⁰ (Emphasis added.)

We agree with the Commission, as well as the FCC and the Federal courts, that Internet usage is jurisdictionally interstate.

Section 251(b)(5) of the Federal Telecommunications Act states that all telecommunications carriers have: "The duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications." Section 252(d)(2) goes on to provide that reciprocal compensation rates approved by state commissions should allow for the reasonable recovery of a carrier's "additional" cost of terminating interconnected traffic. However, reasonable recovery can include "bill-and keep" arrangements where the parties agree to the "offsetting of reciprocal obligations."¹¹

Both this Commission and the FCC have determined that reciprocal compensation only applies to local communications. The Commission adopted this approach in its preferred outcome proceeding, where it adopted a "bill and keep" approach as the preferred outcome and also clearly said that the reciprocal

¹⁰ *In the Matter of Jurisdictional Separations Reform and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, Comments of the People of the State of California and the Public Utilities Commission of the State of California, dated December 9, 1997.

¹¹ Section 252(d)(2)(B)(ii)

compensation terms only apply to local traffic as defined by Pacific's tariffs, namely traffic that is originated and terminated within Pacific's local calling area (approximately 12 miles in length).¹² The FCC has reached the same conclusion in its *Interconnection Order*, where it said:

We conclude, however, as a legal matter, that transport and termination of local traffic are different services than access service for long distance communications. Transport and termination of local traffic for purposes of reciprocal compensation are governed by Sections 251(b)(5) and 252(d)(2) while access charges for interstate long-distance traffic are governed by Sections 201 and 202 of the Act. The Act preserves the legal distinctions between charges for transport and termination of local traffic and interstate and intrastate charges for terminating long distance traffic.¹³

The FCC went on to add:

We conclude that Section 251(b)(5) reciprocal compensation obligations should apply only to traffic that originates and terminates within a local area as defined in the following paragraph. We find that reciprocal compensation provisions of Section 252(b)(5) for transport and termination of traffic do not apply to transport or termination of interstate or intrastate interexchange traffic.¹⁴

These holdings plainly eliminate any application of the Act's reciprocal compensation provisions to interstate or interexchange traffic, thus foreclosing the notion that the Act somehow requires that we "reciprocally compensate" CLCs for the interstate traffic they pass through our local network.

¹² D.95-12-056, Appx. C at 13-14.

¹³ *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98, First Report and Order, FCC 96-325 (rel. Aug. 8, 1996), at para. 1033.

¹⁴ *Ibid.*

Moreover, it is curious to note the conspicuous absence of AT&T from its normal partners in the Coalition. This could be due to the fact that AT&T believes that ISP traffic is interstate in nature.

AT&T has taken the position before the Commission that ISP traffic is overwhelmingly and inseparably interstate in nature and is unlike local business traffic because, for the vast majority of traffic, it is switched by the ISP at its local POP to distant data centers or Internet sites located in other states (or other countries).¹⁵

We agree with AT&T's characterization of ISP traffic as interstate. AT&T also stated that "ISPs use exchange access facilities to provide interstate services; hence an exemption was required to remove ISPs from the federal access charge rules."¹⁶ [Emphasis in original.] We could not have said it better ourselves.

The rulings by the FCC and the courts that ISP traffic is interstate is fully supported by the physical routing of the traffic. Internet calling is a communication that begins with an end user in California dialing a telephone number for connection to an ISP. The call passes through our central office and is placed on an interconnection trunk for completion through another local exchange carrier's switch. At the CLC's switch, the call is then placed on another trunk and sent to an ISP's router which may be located in another LATA. At the ISP's router, however, the communication does not "terminate," but instead the connection remains open and the caller can communicate through the Internet with data bases in other states and countries.

¹⁵ *In The Matter of Request by the Association for Local Telecommunications ("ALTS") for Clarification of the Commission's Rules Regarding Reciprocal Compensation for Information Service Provider Traffic*, Docket CCB/CPD 97-30, Comments of AT&T Corp., p. 2.

¹⁶ ALTS Reply Comments of AT&T Corp., p. 2.

Contrary to the assertions of the Coalition, ISP functionality generally is not located within the local calling area. As the attached diagram illustrates,¹⁷ an ISP modem may or may not be located within twelve miles of the end user. These modems simply place incoming traffic on high capacity transport facilities that are processed in centralized ISP routers and servers. From here traffic is relayed across state and national boundaries via the Internet. Clearly traffic routed to ISPs does not terminate in the end users local calling area.

Under the FCC's and this Commission's rules, which focus on where a call originates and terminates, these communications are interstate in nature because they permit communications that originate in one state and terminate in another. In this sense, the ISP router is plainly equivalent to a giant "leaky PBX," where a caller can access the ISP router through a "local" number, but communicate all over the world once that connection is completed.

The rules for determining whether a communication is local or interstate in nature are based on where the communication originates and terminates, and the operation of the Internet clearly shows that these kinds of communications originate and terminate at different interstate or international locations.

B. Paying CLCs For The Termination Of ISP Traffic Is Confiscatory, Anti-Competitive And Poor Public Policy.

Under the Coalition's interpretation of "local calls," CLCs will recover charges from their ISP customers and they also will recover "per minute" charges from Pacific Bell for the termination of interstate ISP traffic on their networks. Pacific

¹⁷ See Internet Service Provider Alternative Network Configurations diagram attached as Exhibit A.

Bell, however, will receive little, if any, compensation from the CLCs for the use of our network. In other words virtually all ISP minutes are originating on our network. As a result compensation for the use of the respective carrier's networks only goes to the carrier that has the customer relationship with the ISP. This practice has been referred to as the equivalent of a broken ATM machine giving away money to whomever plugs into it. It is obvious that this arrangement is fundamentally unfair to the carrier that does not serve the ISP. What may not be readily apparent is that when this type of recovery, if sanctioned, can lead to competitive abuses. For example, at least one CLC appears to be using Pacific Bell's payments for Internet traffic to fund payments to ISPs for traffic delivered to the ISPs. A Pac-West advertisement explains that ISPs can "get paid for offering free Internet access."¹⁸ That is, instead of charging the ISP to connect to their network, CLCs instead can remit some of their ill-gained local reciprocal compensation payments to pay these ISPs for connecting to the CLCs in the first place. These incentives would not be based on the CLC being an efficient carrier. Instead, these incentives would be supported by a regulatory framework that allows carriers to "game" the system by receiving net positive payments from other LECs that transport originating Internet traffic. Moreover, the ability to "game" the system is not symmetrical. Pacific Bell cannot offer some of the "incentives" that a CLC could offer. Even if we wanted to pay ISPs to subscribe to our service, we cannot do so because our tariffs do not allow it. Furthermore, since we are prohibited by law from charging our end users, ISPs, or other carriers access

¹⁸ See Exhibit B, attached.

charges for the interstate access costs they are causing, we are in effect forced to subsidize the CLCs and their interconnecting ISPs for the interstate communications originating from our customers.

The subsidy arises because Pacific Bell is forced to bear all the costs of originating these calls on its network and is not permitted to pass these costs on to end users. The Coalition's view of the Agreement is even more egregious than a pure subsidy. Indeed, the termination payments would be so large that Pacific Bell would pay all the origination and termination costs, and pay a "bounty" to ISPs (through the CLCs) to encourage even greater use of our network.

C. Pacific Has Not Violated Public Utilities Code Section 453.

The Coalition has raised the false allegation that our refusal to treat local and ZUM Zone 3 calls to ISPs violates Public Utilities Code Section 453. That section prohibits the granting of any preference or advantage or subjecting someone to any prejudice or disadvantage. It also forbids maintaining any unreasonable difference between classes of service.¹⁹ The Coalition implies that Pacific charges local rates for calls to ISPs. However, the Coalition is fully aware that with the widespread use of local flat rate service, Pacific Bell's customers generally pay no additional charge for each individual local call. Zum Zone 3 charges do not come into play with ISP traffic because the CLCs specifically assign to ISPs NXX codes that allow the customers to call the ISPs without incurring those charges. The Coalition's allegation that we provide interLATA telecommunications service is also misplaced.

¹⁹ California Public Utilities Code Section 453

Our Internet subsidiary is not providing interLATA services over its own facilities, nor is it acting as a reseller of interLATA services. Our Internet subsidiary fully complies with the FCC order on the subject.²⁰ The Coalition's allegations fail to stand up to scrutiny.

The Coalition charges that Pacific gains revenue from local calls to ISPs, but does not share that revenue with the CLCs that have incurred switching and other costs. As we have pointed out, flat rated service provides no additional revenue to us for calls to ISPs. Since this is not local traffic and access charges are prohibited by the FCC, there is no revenue to share. Moreover, it is well known that charges for local service do not cover our costs. We should be allowed to cover our costs with our revenues for local service and CLCs should cover their costs with the revenue they receive from their ISP customers. We are not discriminating against CLCs; our subsidiary is not providing interLATA service; and there are no excess local revenues that we are refusing to share with the CLCs.

III. CONCLUSION

The Commission should deny the Coalition's Motion for the following reasons:

- The FCC and the courts have found ISP traffic to be interstate in nature. Interstate traffic is exempt from reciprocal compensation under the interconnection agreements.

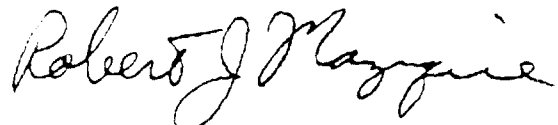
²⁰ *In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, CC Docket No. 96-149, First Report and Order and Further Notice of Proposed Rulemaking, December 24, 1996, para. 120.

- If the Commission requires us to pay reciprocal compensation for ISP traffic, our costs of providing the service will not be covered while the CLCs will be overcompensated. It would be fundamentally unfair to force us to subsidize the operations of the CLCs and their ISP customers.
- Subsidizing CLC service to ISPs will jeopardize universal service and force Pacific Bell end users to pick up the cost.
- This arrangement is poor public policy because it unfairly denies us the ability to compete for ISP business since we cannot pay ISPs to be our customers the way CLCs can.

If the Commission does not deny the motion, it should require bill-and-keep arrangements for Internet traffic. Finally, if the Commission entertains the Motion, it should open a broad proceeding to examine the jurisdictional nature of Internet traffic and the impacts of requiring reciprocal compensation - versus bill-and-keep - for one-way interstate ISP traffic.

Dated at San Francisco, California, this 2nd day of April, 1998.

Respectfully submitted,



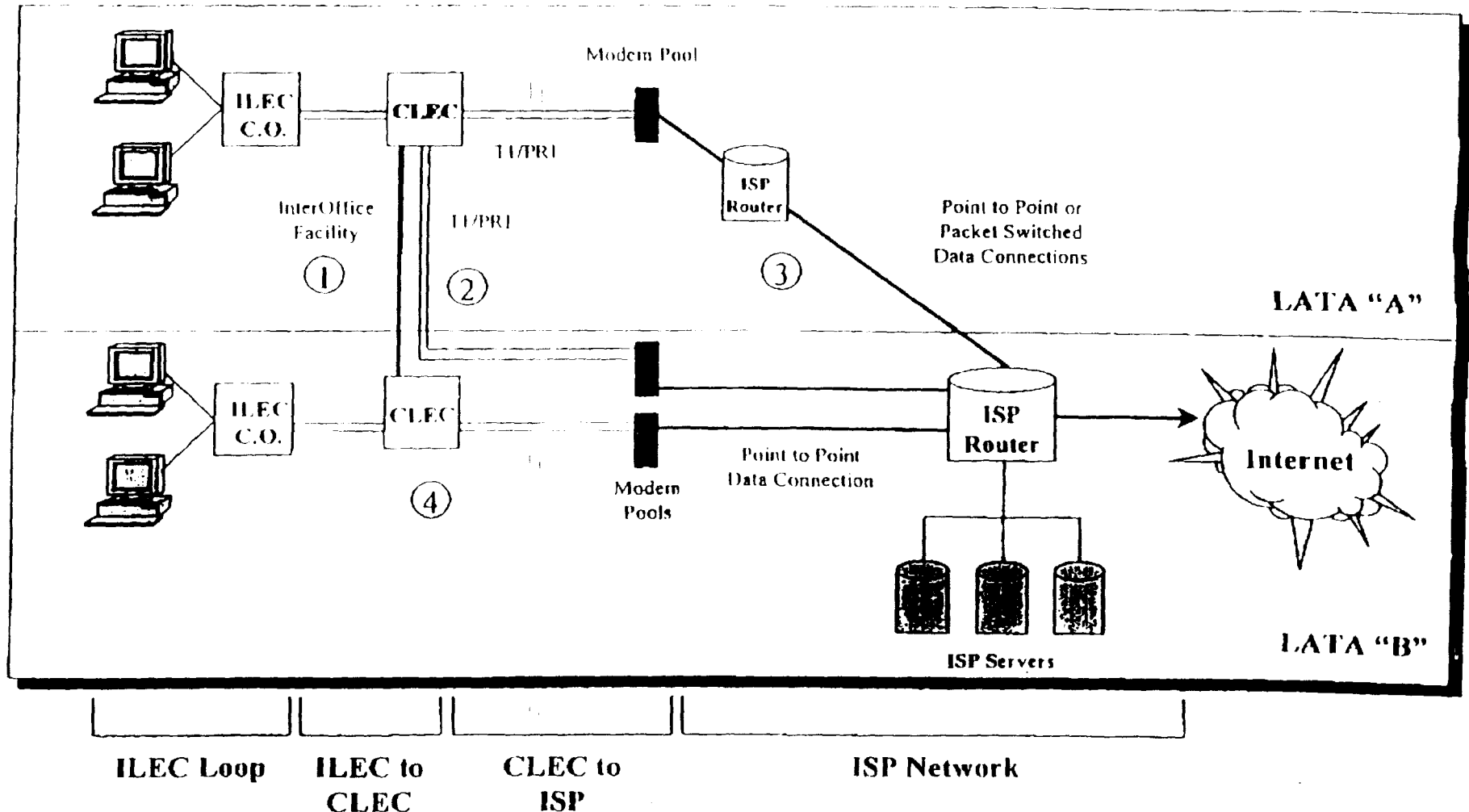
JAMES B. YOUNG
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Attorneys for Pacific Bell

EXHIBIT A

Internet Service Provider Alternative Network Configurations



In Alternatives 1 and 2, the call to the ISP is not "answered" by the ISP until the after the call crosses the LATA boundary. Alternative 1 involves interoffice trunking. Alternative 2 involves a foreign exchange-like arrangement. Alternative 4 is purely intraLATA between the CLEC and ISP (although end to end it is still interstate if it reaches the Internet). Alternative 3 is the basis for the Coalition's primary argument, although it ignores the end to end nature of the communication once it reaches the Internet.

EXHIBIT B



Services for Internet Service Providers

A New Concept in Incoming Telephone Service Offers ISP's These Benefits

Better Service, Lower Costs, More Customers
Get Paid for Offering FREE Internet Access
Local Access Numbers Everywhere in Northern or Southern
California

With No Mileage Charges
Multiple Simultaneous Calls On Every Number - No
Hunting Charges
Service From a Major California Based Telephone Company

100% Compatible With 56Kbps Modems (based on manufacturer's
information)

Better Service, Lower Costs, More Customers

If someone could help you:

- Improve your level of customer service while spending less
- Increase your "local telephone number" coverage while reducing your phone bill
- Expand your service offering into new geographic areas at a minimal cost
- Offer FREE Internet access and get paid for it
- Offer 56Kbps dial up service at a very reasonable cost

Would that interest you?

**Pac-West allows all of the above and more! If that interests you,
please read on...**

FREE Internet Access

Would the ability to advertise and offer FREE Internet access to your customers, while getting paid approximately the same per hour of use as you receive on your high usage \$19.95 per month Internet access help you get new customers?

Would that interest you?

No Mileage Charges

Would foreign exchange type service that offers a local call from virtually any city in Northern or Southern California for only \$10 per month with NO per minute charges and NO mileage costs, help you get more sales and more profits?

Would that interest you?

Multiple Simultaneous Calls

What if each telephone number your customers dial could carry multiple simultaneous calls for the same single \$10 a month charge? What if any additional trunks needed to carry your calls to the telephone company's switch were added without you having to ask, and without any charge to you? Would that increase your level of service, decrease your customer complaints and save you money?

Would that interest you?

Better Service with Fewer Modems

What if all your calls from all over Northern or Southern California were aggregated into one common modem pool so you could increase the number of users per modem while actually increasing the level of service you provide? Think of the money you would save on modems as you grow and the customer complaints that would go away.

Would that interest you?

Offered By A Major Telephone Company

What if the company that offered you that service was a large telephone company with over fifteen years experience in California and is already handling over 2 1/2 million calls a day?

Would that interest you?

— Offers Digital Trunks That Support 56Kbps Modems

What if there were a very economic way to offer 56Kbps dial up service with any one or all of the three 56Kbps modem technologies being offered?

Would that interest you?

Your Competitors Are Doing It

What if your competitors took advantage of this offer to expand their service areas, improve their quality of service and reduce their costs and you didn't?

Would that affect your business?

To receive a written proposal on the new telecommunications service for ISP's

➤ [Click Here](#) ➤